Reforming the Cable Franchise System

MB Docket No. 05-311
Response to the Request for Comments on the *Notice of Proposed Rulemaking* FCC 05-189

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COMMENTS OF THE PACIFIC RESEARCH INSTITUTE

The Pacific Research Institute (PRI), a think tank based in San Francisco, respectfully submits its comments for MB Docket No. 05-311 (*Notice of Proposed Rulemaking* FCC 05-189), pursuant to the request of the Federal Communications Commission (FCC).

Founded in 1979, PRI promotes the principles of individual freedom and personal responsibility in the public policy process. The Institute believes these principles are best encouraged through policies that emphasize a free economy, private initiative, and limited government. By focusing on issues such as education, the environment, health care, entrepreneurship, and technology, the Institute strives to foster a better understanding of the principles of a free society among leaders in government, the media, and the business community.

PRI's Technology Studies Department, led by director Sonia Arrison, serves as an educational resource for the tech community, and a policy force at the local, state, and national level. Through policy papers, public testimony, and published opinions, Ms. Arrison and her policy staff communicate the importance of facilitating high-tech investment and innovation in our society.

INTRODUCTION AND SUMMARY

Convergence is the ongoing theme in the nation's communications marketplace, and for the most part it is happening at a decent pace. One area, however, where positive change is not happening fast enough is in the area of video service. The reason for this lag can be traced directly to the cable franchise regulatory system where local governments set the terms and conditions for businesses to enter the video market.

Attempts to foster competition and provide consumer protection in the video programming market have been stymied by local governments that hold a vested interest in maintaining the current near-monopolistic system. All too often, alternative cable franchise bids are ignored, costly entry barriers are raised, and lawsuits are filed to block service choice for consumers. As a result, less than five percent of incumbent cable providers now face effective competition.[1] With basic and premium cable rates reaching all-time highs, and municipalities shutting out new, affordable video technologies, government failure in protecting the public interest is clearer than ever. The legal regime of cable franchise agreements is broken, abused, and must come to an end.

1) Local franchise authorities are unreasonably refusing to grant competitive franchises.

The unspoken premise behind the cable franchise system is that cities are regulating a monopoly service for local residents. In exchange for charging high franchise fees and receiving significant financial and service concessions from cable companies, cities tacitly agree to insulate franchisees from market competition. This practice still thrives today, despite the fact that Congress has passed a series of laws to curb the market distortion and political favoritism caused by municipalities.

It can take from six to eighteen months to be awarded a local franchise agreement (LFA), a cumbersome process that usually requires expensive lobbying campaigns and multiple rounds of private and public negotiation.[2] Franchise agreements are typically limited for 10-15 years, and are subject to a lengthy renewal process.[3]

Despite the federal checks on local franchise power, municipalities still have broad authority to establish their own provisions, fees, and franchise requirements. Though federal law explicitly prohibits monopolistic cable franchises,[4] municipalities and cable operators have found alternate ways to maintain their lucrative non-competitive franchise agreements.

Some municipalities have perversely used the franchise bidding process to strong-arm unfair agreements from cable providers, such as requiring corporate funds to help cover local budget shortfalls, or the procurement of unrelated goods and services for public use by cable operators.

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[1] United States. Federal Communications Commission. Annual Assessment Of The Status Of Competition In The Market For The Delivery Of Video Programming. 11th Edition. Washington: FCC, 2005.
[2] For an example see: Edwards, Greg. "Verizon Wants Into Cable TV Business." Richmond Times 3 February 2005.
[3] Gardner F. Gillespie, *Rights-of-Way Redux: Municipal Fees on Telecommunications Companies and Cable Operators*, 107 Dick. L. Rev. 209 (2002).
[4] 47 U.S.C. § 541(a)(1).

Although federal laws have since tightened what can be demanded, city officials still find creative ways to push the legal envelope.[5] Additionally, millions of dollars are usually necessary to fund advertising, lobbying costs, political access, and other forms of "franchise campaigning" that greases municipal wheels towards obtaining a LFA.

One of the biggest regulatory hurdles for competitors to clear are LFA "build out" provisions, which require franchisees to universally install cable hardware throughout a city. This capital-intensive demand serves to seal monopolistic conditions, as only a single provider market would likely facilitate cost recovery for investments made by MVPDs. Though city officials and cable companies argue that build out laws are about "fairness," the reality is that millions of American households don't actually need or desire government-driven expansion of video programming, just as there are millions who turn down broadband service despite heavy promotional discounts from competitive broadband providers.

2) The FCC should address important video regulatory issues at the state level.

In an effort to "equalize" incumbent and rival franchisees, some state legislatures have passed "level playing field" (LPF) laws for video programming providers. Most of these laws require that new video programming franchisees must carry a regulatory burden at least equal to the incumbent's, saddling would-be cable competitors with the same inane and peripheral rules. These "fairness" measures have in effect served as market entry barriers for rival multichannel video programming distributors (MVPDs), which would not be likely to match the financial strength and resources of incumbents. At least eleven states have LPF laws on the books, and an increasing number are stipulated in the LFAs themselves.[6] LPF legislation adds to the array of large, mandatory initial costs to place a franchise bid, thwarting competition in local markets.

3) The Federal Communications Commission should broadly interpret the pro-competitive mandate of Section 621(a)(1).

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[5] Due to regulatory changes under the 1996 Telecom Act, cable operators cannot be required by municipalities to provide voice or Internet services to obtain a franchise, other than for connectivity for local government buildings.

[6] States with LPF laws include Alabama, California, Connecticut, Florida, Illinois, Kentucky, Minnesota, New Hampshire, Oklahoma, Tennessee, Virginia. Source: Hazlett, Thomas W. and George S. Ford. "The Fallacy of Regulatory Symmetry: An Economic Analysis of the 'Level Playing Field' in Cable TV Franchising Statutes." Business and Politics Vol. 3, No.1 (2001): 21-46.

Federal laws have done little to rein in the power of franchising cities, and the competitive benefits of a healthier market are still absent from most municipalities. As local governments continue to squander their public responsibility to serve the greater interest, and consumers are stuck with rising cable rates, urgent action is needed from the FCC to reform the local franchise regime.

There are currently more than 30,000 local cable franchise authorities in the United States.[7] With a market controlled by thousands of different municipal, state and federal standards, new video programming entrants must endure a hornet's nest of red tape to even begin providing service to customers. This daunting task is almost impossible for smaller cable companies and industry entrepreneurs, who struggle to match the market power and fiscal strength of incumbent cable providers that make billions each year keeping competitive alternatives away from their consumers.

Currently, provisions under the 1992 Cable Act allow for cable rates to be marginally reduced in lieu of effective competition within a municipality. However, this price control mechanism fails to deliver the superior consumer benefits of having wireline "overbuild" competition.[8] FCC data shows that when cable service providers are allowed to compete in a city, consumers are offered lower cable rates, more channels, and have a better price-per-channel ratio than consumers in non-competitive municipalities.[9]

	Without Competition	With Wireline Competition
Monthly Cable Rate	$45.56	$38.80
Channel Selections	70.1	74.9
Price-Per Channel	$0.665	$0.523

Source: Federal Communications Commission

[7] Source: Federal Communications Commission.
[8] Kurth, Joel. "Customers With Options Are Happier; Cable Competition in Metro Detroit; Rates and Service Rank As Top Gripes of Cable Viewers." Detroit News 28 June 2002: Pg. 06A; United States. Government Accountability Office. Telecommunications: Subscriber Rates and Competition in the Cable Television Industry. Statement of Mark L. Goldstein. Washington: GAO, 2004.
[9] United States. Federal Communications Commission. Annual Assessment Of The Status Of Competition In The Market For The Delivery Of Video Programming. 11th Edition. Washington: FCC, 2005.

Underscoring this phenomenon, federal investigators found that when interviewing cable franchise operators, they revealed that they "generally lower rates and/or improve customer service where a wire-based competitor is present."[10]

Consumers deserve better, and marketplace competition must truly be embraced as a public priority.

A streamlined deployment of new video technologies may provide a solution to the competitive debacle of the cable franchising system. Internet Protocol Television (IPTV), which competes with regular cable by delivering video over the Internet, is set to grow tenfold by 2010. [11] This should be good news for the economy, but according to industry reports, the leader won't be the United States. Instead, countries such as China, France, and Italy are forecast to lead.

If America can clean up its franchising system to allow for the quick growth of IPTV, it would not only foster better, faster, and cheaper video services, it would also stimulate economic growth as hardware and software companies will need to provide products and the content industry will have more outlets. Indeed, according to a recent report by the market research firm In-Stat, worldwide revenues due to new "premium services" such as video on demand, digital video recording, and interactive TV will surpass US$600 million in 2009.[12]

Competitive forces are pushing cable companies to attempt to innovate before key competitors can break free of red tape. There's been plenty of discussion about the plans of telco companies like SBC and Verizon to roll out Internet Protocol television (IPTV) to compete with cable. It should be noted that the telcos had no one protecting them from the sudden onslaught of competition in voice from the cable industry, so it wouldn't be fair for the cable industry to get a better deal. Lawmakers should not make Americans wait much longer for government to come through with help in reforming the system. Taking away power and money from local bureaucrats and their paymasters can be a tough slog, but it must be done -- and the faster, the better.

POLICY RECOMMENDATIONS

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[10] Government Accountability Office. Telecommunications: Subscriber Rates and Competition in the Cable Television Industry. Statement of Mark L. Goldstein. Washington: GAO, 2004.
[11] "IPTV to challenge existing pay TV platforms," by Adam Thomas , Informa Telecoms & Media, August 12, 2005.
[12] "Telco TV in Mass Deployment Phase," by Michelle Abraham, In-Stat, August 2005.

There are at least three ways that the current system could be reformed – through state reform, federal legislation, or FCC action. The federal government could pass legislation to address the issue. Indeed, communications is a national, if not international, medium. Therefore, a federal regulatory structure would be preferable to a state structure. Perhaps the best solution would be for Congress to preempt local franchising authority and create a light-touch regulatory structure. That would avoid a costly patchwork of laws and better fit the natural range of the technology. However, if the FCC were to initiate such a move, that would be a positive development as well.

There are some key ideas that should guide the reform process. These include:

- **Federal regulations should be reduced for all video providers.** Companies can provide better packages and rates when industry rules foster capital expenditures and new market investment. Cable, telephone, satellite, wireless, and other providers should be regulated lightly and be allowed to strongly compete for consumer loyalties. Current cable franchisees should also be freed from many of the overly burdensome provisions that distort business practices and policy making.

- **Local and state "level playing field" (LPF) laws are destructive.** LPF laws serve to establish another costly hurdle for competitive MVPDs to clear, squeezing many companies out of the market. A true level playing field law would eliminate burdensome requirements, not extend them.

- **The pork politics of cable franchise negotiations must end.** Federal lawmakers should expressly prohibit the "goodie bag" compensation franchisees routinely fork out for the use of public right of way. Adding costs and responsibilities to an LFA raises cable rates for local residents, many of who will never benefit from the superficial agreements made.

- **"Build out" requirements under local franchise agreements should be discarded.** Forcing video providers to pay for more equipment than is necessary to serve consumers is a wasteful and naïve policy. Facilitating new market entrants is a more sustainable way to achieve local service ubiquity than heavy-handed mandates that needlessly overrun business costs.

CONCLUSION

Innovations in technology are improving the communications landscape, and policy makers must ensure all consumers realize the full benefits. There is a long history of legislation and regulation in this area that includes unfortunate times when local governments used their franchise authority for other, unrelated, purposes.

A healthy communications sector affects how well America can compete with the rest of the world, yet the United States is falling behind. It's time for true reform – for governments to cease the pork politics of cable franchise, for build-out requirements to disappear, and for a stable, technology neutral, and light touch regulatory framework for video.